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SUBJECT: ECONOMIC CRISIS TAKES TOLL ON ARMENIA'S MINING, IT
INDUSTRIES

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SUMMARY

11. (SBU) While the effects of the global economic crisis have not yet been felt broadly in Armenia, the mining and information technology sectors have suffered more severe setbacks. Falling mineral prices have resulted in suspension of mining operations, layoffs and brief worker unrest in several mining-dependent towns. Due to falling sales from foreign customers, several IT firms have closed or laid off staff, with more expected in the coming weeks. In both sectors, there is little expectation that the situation will improve in less than six months. End Summary.

MINING FIRMS SUSPEND ACTIVITY

12. (U) The mining crisis is of great concern to the GOAM not only because mining constitutes four percent of GDP, but because mining activity is substantially concentrated in the country's southern regions, where there are few other economic activities. The three leading mines in the southern Syunik Marz employ 6,000 persons, with 10,000 others working in satellite services that will be affected by the mining downturn.

13. (SBU) The fall in minerals prices has prompted several mining companies to suspend their operations as they wait for prices to rebound, and is causing concern for banks, concerned that low prices increase the risk of repayment default. One local American-owned bank in November declined two loan applications from mining companies, due to falling prices. The Armenian State Employment Agency currently estimates that more than 1,600 mining jobs will be lost in the sector. Among the expected layoffs are 300 from a mine in Alaverdi (northern Armenia) owned by the Armenian Copper Program (ACP); 450 at the Agarak (near the Armenian-Iranian border) Copper and Molybdenum Combine, and an unknown number from Deno Gold, in Kapan (southern Armenia).

14. (U) The Alaverdi mine had been only marginally profitable even when prices were at their peak, and ACP Executive Director Gagik Arzumian told EconOff that the company does not intend to reopen it. ACP continues to operate its mine in Nagorno Karabakh, and has transferred some of its 300 Alaverdi employees there. Falling copper prices are also prompting skittishness from Russia's Vneshtorgbank, which is providing nearly USD 250 million to finance ACP's project to clear-cut and mine the Teghut Forest (reftel). This is a

30-year project that should be immune to short-term price fluctuations. Arzumian told us that the bank has been showing concern about the direction of copper and molybdenum prices, and while it remains committed to the project, has not yet disbursed any funds toward its implementation.

WORKERS REVOLT AT DENO GOLD

15. (U) On November 10, three GOAM ministers--Energy Minister Armen Movsisian, Minister of Economy Nerses Yeritsian and Labor Minister Arsen Hambardzumian--traveled to the southern town of Kapan in an effort to resolve a five-day strike at Deno Gold Mining Company, a copper and zinc mining operation.

On November 6, the General Manager of Deno Gold had announced plans to lay off 60 percent of its workers and impose wage cuts of 40 percent on remaining staff. This followed a mid-October announcement by the company that it would lay off 340 of its 1,500 staff due to falling world prices for copper and zinc. (Note: According to Aram Hakobian, Deno Gold's administrative director--who himself will be laid off in mid-January--salaries currently average about USD 1,200 per month, relatively high by Armenian standards, and certainly in that region. End Note).

16. (U) In July, when world copper prices peaked, Deno Gold had discussed the possibility of expanding its mining operations in Kapan. However, at current prices for copper, molybdenum and zinc, continuing mining activity was not economically justified until world prices rebound. The firm, a subsidiary of Canada's Dundee Precious Metals, claims to have invested over USD 100 million in the Kapan mine since it was acquired in 2006, but says it has never earned a profit.

17. (SBU) As a result of the mediation and a subsequent

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meeting with Energy Minister Movsisian on November 17, Deno Gold agreed to defer all layoffs for three months, after which it would reassess the situation. Armenian media have reported that the GOAM also transferred AMD 800 million (USD 2.6 million) in outstanding Value Added Tax (VAT) refunds to Deno Gold. (Comment: This appears to be a quid-pro-quo. If Deno Gold in fact agreed to retain the employees for three months in exchange for receiving its outstanding VAT refunds, it suggests the company had largely written off any hope of recovering the money, despite the GOAM having provided approximately USD 70 million for such refunds in both its 2008 and 2009 budgets. Other exporting companies have asked us whether the GOAM did, in fact, provide VAT refunds, noting that it would help them transition through this difficult period as well. End Comment).

A CHANCE TO CLEAN HOUSE?

18. (U) Aram Hakobian, Deno Gold's administrative director, told EconOff on November 10 that while Deno's management decision to lay off staff was primarily a response to falling minerals prices, Deno was also attempting to modernize the operation and rationalize staffing. Hakobian said that the mining techniques currently employed by Deno dated from the Soviet era and were decades behind those of western operations. Consequently, even at peak prices, the company had been losing close to USD 300,000 per month. Unlike ACP's Alaverdi plant, Deno fully intends to resume mining operations should prices rebound, although at present it is operating at a "care and maintenance" level.

19. (SBU) The mining crisis has affected primarily companies involved in mining of such base metals as copper, molybdenum and zinc. Gold prices remain high and U.S.-owned Global Gold reports that its business is still performing well, although the financial crisis is making it more difficult for the firm to find working capital; a recent bank financing deal worth several million dollars collapsed. The firm employs 300 people in the warm-weather months, and about 150 during the winter, when it processes stockpiled ore.

FALLING DEMAND HITS IT SECTOR

¶10. (U) Since mid-November Armenia's information technology industry has seen a sharp falloff in business, and as in the mining sector, many expect the downturn to last at least six months. Exports account for nearly 80 percent of these firms' sales, and much of the decline in this sector is the result of falling demand from U.S. customers. Armenian firms are particularly vulnerable to declining demand for internet advertising, enterprise and systems integration software. Problems for Armenian IT firms are not limited to falling sales, however; many of their customers are defaulting on their payables, as well. Troubles may worsen yet, as many Armenian IT firms have contracts with their customers that expire December 31 and may not be renewed.

¶11. (U) Two IT firms have already announced plans to close or scale back vastly their operations, and several others have undertaken significant staff reductions, with more likely to occur in the coming weeks. Lycos Europe, which employs 200 persons at its Armenian subsidiary, on December 15 formally announced plans to close by March; workers have already begun receiving layoff notices. The U.S.-based EPIGY Labs has laid off most of its research and development staff and retained just a few operations staff, and U.S.-owned Virage Logic is also laying off staff. (Note: It is likely that neither firm's closure is attributable entirely to the global financial crisis. Lycos has been in trouble for some time and management has been trying, under pressure from shareholders, to sell the company since early 2008. EPIGY had its own operational difficulties. The crisis may have exacerbated their troubles, however. End Note).

¶12. (U) The situation is not dire throughout the industry, however. Synopsys, a U.S. firm with 500 employees in Armenia, reports a strong performance in 2008 in its worldwide business and remains optimistic for 2009. It anticipates hiring new staff in Armenia and expansion of its college training program. Credence Systems, another U.S. firm with approximately 60 local employees, reports that business remains strong and hopes to expand to 100 employees by the end of 2009 and ultimately to nearly 200.

¶13. (SBU) Problems in the IT sector have caused considerable concern for the GOAM, which is counting on the sector as a pillar of the country's economic development. Currently

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there are 200 IT firms in Armenia, 60 of them foreign. Leaders in the IT sector met in Dilijan December 6-7, where Minister of Economy Nerses Yeritsian discussed the possibility of emergency financing for Armenian IT firms. In a move similar to bailouts in the U.S., the GOAM has already made equity investments in a few IT companies in order to sustain them over the course of the current downturn. If the GOAM is successful in obtaining funds for SME lending from international financial institutions, the IT sector will likely be one of the major recipients of that lending.

¶14. (SBU) The GOAM has also expressed a desire to keep the Lycos team as intact as possible in order to take advantage of their collective expertise, even going so far as to suggest keeping them working in the same building, under a different employer (still to be determined), once Lycos has closed down. The Lycos staff account for three percent of the country's IT workforce of 6,000. Among the potential consequences in Armenia of an IT sector collapse is not only the loss of employment for skilled IT workers, but also the possibility that some may move abroad in search of employment. Loss of workers in this and other sectors with relatively high wages may have an impact on the consumer credit markets as well. Many IT workers, with higher-than-average incomes, hold a disproportionate share of car loans, mortgages or other significant debts on which they may be prone to default if they remain unemployed for long.

COMMENT

¶15. (SBU) The problems in both the mining and IT sectors are evidence that the Armenian economy is more vulnerable to external market conditions than some initially wanted to acknowledge. While it is understandable that the GOAM would hope to help sustain the mining and IT sectors, its options are limited, given their dependence on exogenous factors--world market prices and export demand, respectively.

Barring a turnaround in prices in the near-term, Deno Gold will almost surely undertake the layoffs once the three-month deferral expires. There is also little that the GOAM can do to stimulate demand in the IT sector in order to avoid layoffs there. However, as one IT executive told EconOff, this is also an excellent time to start a new IT firm, as it is a buyer's market for talent. End Comment.

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